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This week, the Department of Labor (DOL) proposed a rule to clarify what factors should – and should not – drive plan fiduciaries' investment of plan assets. Another much-anticipated proposal from DOL related to a "best interest" standard for individual investment advice is still at OMB.

In response to the significant rise in environmental, social, and corporate governance (ESG) investing, impact investing, and the like, this proposed rule makes clear that plan fiduciaries may never subordinate the *financial* interests of plan participants and beneficiaries to non-financial ESG-type investment objectives.

By way of background, ERISA imposes several responsibilities on plan fiduciaries, including acting:

- Prudently and diversifying plan investments to minimize risk of large losses;
- Solely in the interest of the plan's participants and beneficiaries; and
- For the exclusive purpose of providing benefits to participants and beneficiaries, and defraying plan administration costs.

Courts and DOL have interpreted that third duty – the "exclusive purpose rule" – to mean acting with complete loyalty to, and with the single purpose of, promoting the financial interests (risk-returns) and plan benefits of participants and beneficiaries.

DOL has for years followed the "tie-breaker" approach to ESG-type investments – *all* things being equal (e.g., expected rate of return, risk characteristics, diversification, degree of liquidity investment policy of the plan, fee structure, etc.), plan fiduciaries may use non-pecuniary considerations to make a final investment decision. When ESG issues have a direct bearing on the economic merits of an investment (i.e., when ESG factors have a material impact on the financial risk-return of investments), they do not have to be treated as tie-breakers; but here, it is not enough to say, for instance, that ESG factors generally promote positive market trends or growth.

The proposed rule purports to consolidate, simplify, and clarify existing sub-regulatory guidance. It keeps the tie-breaker model, but adds a documentation requirement for fiduciaries to record "economically indistinguishable" alternative investments and more explicit detail regarding prohibited plan fiduciary actions. As summarized in the preamble: "[I]t is unlawful for a fiduciary to sacrifice return or accept additional risk to promote a public policy, political, or any other non-pecuniary goal."

The proposal gives plan fiduciaries a bit more leeway when selecting menu options for participant-driven individual accounts. Providing ESG alternatives within a broad range of investment options is viewed positively as giving participants/beneficiaries more choice and does not require an “economically indistinguishable” analysis compared to other investments on the platform. Fiduciaries still are required, however, to make sure any ESG alternatives are well managed, properly diversified, and prudently selected based on objective risk-return criteria.